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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

Nos. 278, 279, 280, 281 and 282

IN THE MATTER

of

THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY,

Debtor.

RECONSTRUCTION FINANCE CORPORATION, INSURANCE GROUP COMMITTEE, *et al.*,

Petitioners,

against

THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY, *et al.*,

Respondents.

(and the other four cases numbered above)

BRIEF IN OPPOSITION ON BEHALF OF THE DEBTOR-RESPONDENT, THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY

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In the Petition (No. 286) in the nature of a Cross-Petition for a writ of *certiorari* filed by the respondent, The Denver and Rio Grande Western Railroad Company (herein called the Debtor), for the purpose of bringing up the entire case in the event that this Court shall determine

to issue writs of *certiorari* pursuant to the Petitions (Nos. 278-282) of senior creditors it is stated:

> "To avoid duplication of the argument against the granting of that Petition this Petitioner adopts as its answer thereto such answer as shall be filed by the City Bank Farmers Trust Company, as Trustee under the Debtor's General Mortgage, reserving the right, however, to supplement such answer within the period permitted by the Rules of this Court."

City Bank Farmers Trust Company, as such Trustee has filed in lieu of an Answer an opposing Brief dated August 31, 1945. The Debtor concurs generally in that Brief. While the General Mortgage Trustee's Brief does not go as far as we think it should go in condemning as confiscatory the Plan of Reorganization to which this controversy relates and contains arguments from a strictly creditor standpoint which the Debtor's counsel might wish to qualify or to question in a clear-cut contest between creditor and equity interests, it is manifest that that is not this case. Here the issue is whether senior lien creditors are to be suffered to appropriate and to take for themselves not only the valuable equity represented by the Debtor's capital stock but also take 90% of the superior creditor investment secured by the Debtor's General Mortgage (Rec., pp. 36, 37; 183).

Only to a very limited extent—and even to that extent largely for the purpose of emphasis—does the Debtor feel that it might be helpful to this Court for it to supplement the comprehensive Brief filed by the General Mortgage Trustee.

The names of Reconstruction Finance Corporation and the Solicitor General of the United States appear in a conspicuous and perhaps misleading position at the head of the Petition. The Government as such is not interested in this proceeding. Let it be clearly understood therefore

that Reconstruction Finance Corporation is merely a secured creditor of the Debtor and is not otherwise interested in this proceeding and that no question involving its corporate powers or authority arises herein.

We agree with City Bank Farmers Trust Company that the Petition of the senior lien creditors is seriously inaccurate and attempts to state and present questions to this Court which do not arise under the decision of the Circuit Court of Appeals. Indeed we think this Court will find their Petition to be a mosaic of mistake, misunderstanding and misrepresentation. The statement appearing on page 2 that the decision of the Circuit Court of Appeals forces "substantial awards of cash and new senior securities to holders of old junior bonds" is typical. This statement is repeated not less than seven times at subsequent pages of their Petition.* The real facts are clear. The Interstate Commerce Commission's Plan gives nothing whatever to the junior Bonds but *common stock* and this is given for only 10% of their claim (Rec., p. 182). The District Court approved this treatment but the Circuit Court of Appeals held that this percentage of common stock could and must be increased as a matter of law to the extent possible within the limits of (a) the Commission's valuation of the Debtor's properties, and (b) the Commission's authorization of total reorganization capitalization. Common stock is the only currency required or permitted by the decision of the Circuit Court of Appeals. Should the Commission itself determine on reconsideration of the whole case in accordance with subsection (d) of Section 77 of the National Bankruptcy Act to revalue the properties so as to give effect to increased earning power due to heavy capital expenditures assuring greater efficiency and economy of operation; to the establishment of new productive industries of which the great $200,000,000 steel plant at Geneva is the outstanding example; to radical changes

* See pages 9, 10, 12, 13, 15, 16.

in traffic movements more nearly equalizing the loadings east bound and west bound; and to a dozen or more significant if not vital factors which should be given effect in order to avert a forfeiture of vested equity interests; then the increased valuation would be represented not by "cash and new senior securities" but only by a larger percentage of common stock. Even in that event part of the increased valuation may if the Commission so elects be represented by a junior issue of common stock designed only to pick up excess earnings in times of extraordinary prosperity (see Opinion of Judge HUXMAN, Rec., p. 253).

The Order or Decree of the Circuit Court of Appeals reverses two Orders of the District Court (Judge SYMES)—one an Order of the District Court approving the Plan of Reorganization certified to it by the Interstate Commerce Commission *before* it had been submitted for acceptance or rejection by creditors; the other an Order confirming the Plan *after* its submission to creditors and its rejection by a four to one vote of the holders of General Mortgage Bonds voting thereon (Rec., pp. 207; 224).

In order to override this veto and confirm the Plan it was necessary for the District Court judicially to determine *inter alia*:

> "* * * that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts" (11 U. S. C. A. Sec. 205(e)).

One of the relevant facts which standing quite alone would reasonably justify the action of the General Mortgage Bondholders in rejecting the Plan was the striking fact that over a period of steadily increasing prosperity the treatment accorded the General Mortgage Bonds had been revised downward from 100% treatment under the Plan first filed by the senior creditors and 33⅓% treatment offered under two prior Plans approved by the Interstate

Commerce Commission itself to 10% treatment under the Plan which these Bondholders wisely rejected. Their investment had waned under the erosion of steadily rising prosperity. This they knew was solecistic (see Plans dated June 15, 1937; July 11, 1939 and April 2, 1940).

A second relevant fact which also standing alone would reasonably justify the action of the General Mortgage Bondholders in rejecting the Plan was that the 10% treatment finally accorded them was to be represented by $4,354,816 par value of common stock taken at $100 per share which was actually less than one-half of the income earned *pendente lite* on the General Mortgage Bonds and lawfully impounded by the Mortgage Trustee (see Opinion of Judge PHILLIPS, Rec., p. 257). To this significant disclosure the senior creditor interests make the following *naive* answer:

> "Finally it should be noted that the claim of City Bank to a lien on any funds by impounding is without any basis. The Trustees from their appointment held all earnings for bondholders in the order of their priority and in addition petitions for sequestration were seasonably filed by the Indenture Trustees under all senior issues. Bonds secured by a senior lien on each half of the system, the Western Trusts and the Eastern Consolidateds have matured with a total claim of $76,551,000. All earnings are subject to a senior lien for the full payment of that whole amount before there can be anything for the General Mortgage bondholders and that has not been done. So this argument gives no special equity to the City Bank."

Of course the City Bank is not entitled to take in cash as against senior lienors the income earned by the Trustees applicable to General Mortgage interest. Such cash is primarily applicable to the matured principal of the senior lien debt. When so applied, however, the amount of the prior debt ahead of the General Mortgage Bonds

which must be taken care of out of the new capitalization authorized by the Commission is correspondingly reduced and this reduction at once makes available for them equivalent amounts of the new capitalization allocated to the senior lien Bonds. Since that had not been done the General Mortgage Bondholders had been maltreated and were in duty bound to reject the Plan.

A third relevant fact which reasonably justifies the action of the General Mortgage Bondholders in rejecting the Plan is the emasculation of their equity in the stock of the Utah Fuel Company. In spite of what is said in the Petition of the senior creditors (Rec., pp. 21-22) this stock (a) is given outright and irretrievably to the holders of the Bonds issued under the Rio Grande Western Consolidated Mortgage, and (b) is given to these Bondholders as a *bonus* without a disclosed valuation after they have been made whole.

Let there be no misunderstanding on this point.

In the Second Supplemental Report the Commission says:

> "In our opinion these bondholders are entitled to receive the beneficial interest in the Utah Fuel stock in addition to the reorganization securities allotted to them. The approved Plan so provides" (Rec., p. 136).

In the Third Supplemental Report the Commission reiterates:

> "Under the Plan the old bondholders would receive directly the ownership or the proceeds of the Fuel Company stock" (Rec., p. 167).

The stock of the Utah Fuel Company was originally pledged subject to withdrawal against the deposit of $6,000,000. This right of redemption was subsequently vested in The Western Pacific Railroad Corporation and the

Missouri Pacific Railroad Company in which Companies the naked legal title to the stock also was vested; but, by the same instrument or a contemporaneous instrument the stock and the entire equity of redemption were further pledged under the Debtor's Refunding and Improvement Mortgage and its General Mortgage in the order of their respective priorities (Rec., p. 52; Exs. 34-35).

Under the Commission's Plan the whole beneficial interest in the Utah Fuel stock is given *pro rata* to the holders of the Rio Grande Western Consolidated Bonds—in kind in case the Mortgage Trustee secures the release of the right to redeem at $6,000,000 as provided in an original agreement of pledge; in cash if the Mortgage Trustee is forced to foreclose in order to extinguish this right of redemption (Rec., p. 77).

To say, as to the senior creditors, that the Utah Fuel Company stock as Accommodation Collateral is left undisturbed by the Plan in accordance with the decision of this Court in *Ecker et al.* v. *The Western Pacific Railroad Company*, 318 U. S. 448, is to ignore all the facts of record to which we have referred. Apart from this, however, the basic rule asserted in that case is inapplicable here. That rule is that Accommodation Collateral can only be resorted to after exhaustion of the collateral directly pledged by the principal Debtor. Here there is an express agreement in favor of the Debtor's junior lien Bondholders and Preferred Stock that the stock of the Utah Fuel Company must be liquidated and applied to the payment of the Western Consolidated Bonds before there can be any resort to the other mortgage security. The General Mortgage Bondholders are entitled to require that this procedure be followed and are reasonably justified in rejecting a Plan which ignores their contract rights (Ex. 35—I. C. C. Rec., Vol. 7, p. 3171).

A fourth relevant fact which reasonably justifies rejection by the General Mortgage Bondholders of a Plan of

Reorganization that leaves 90% of their investment unprovided for is the Report of the Judiciary Committee of the House of Representatives showing that the threatened forfeiture is the consequence of a misunderstanding and misinterpretation of Section 77 on the part of both the Interstate Commerce Commission and the Courts. The entire investment may, however, be retrieved upon a reference of the proceeding back to the Interstate Commerce Commission after rejection under Subsection (c) for a new Plan under Subsection (d) if any *one* of three events shall occur: i, the passage of the proposed legislation; ii, a more liberal attitude on the part of the Interstate Commerce Commission, and iii, a modification by this Court of its opinions under Section 77 to conform to the interpretation of the Judiciary Committee. Each of these events was and is a just expectation and a reasonable probability. The legislation already has passed the House of Representatives with but a single dissenting vote and now awaits action of the Senate. The present policy of the Interstate Commerce Commission rests upon the vote of a bare majority—2 to 1—of Division 4 and can no longer be regarded as a fixed, stable policy. This Court has not hesitated to modify its previous opinions to correct mistakes or conform to changes in philosophy or even in ideology; and has always given great if not controlling weight to the formal report of a standing committee of Congress respecting legislation which it originated. Especially is this true of the Judiciary Committee of the House of Representatives.

In formulating Section 77 of the National Bankruptcy Act—which if properly interpreted by the senior creditors is the first legislation which has attempted to take from a pledgor the traditional protection of a public sale—Congress provided three safeguards against confiscation: *first*, a hearing and *quasi* judicial determination by the Interstate Commerce Commission; *second*, an independent judicial review which requires that the Court "be satisfied"

that the pledgor's property rights were fully protected; and *third*, an unconditional right of veto in one-third of each class unless such veto is exercised capriciously without reasonable justification (11 U. S. C. A., Section 205(d)(e)).

The first of these safeguards has proved valueless because the Interstate Commerce Commission acting through a bare majority of Division 4 has persistently subordinated rights of private property to the public interest in low cost transportation which may be assumed to be the ultimate outcome of artificially depressed carrier capitalization. The second safeguard—the independent judicial review of Commission action—has proved equally valueless for the reason as stated more fully in our Petition in No. 286 that this Court (we think erroneously) in the cases of *Ecker et al. v. The Western Pacific Railroad Corporation* and *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul and Pacific Railroad Company and others* has so limited the right of judicial review that the Court is required to be "satisfied" with almost any finding of value certified by the Interstate Commerce Commission even though the Court knows in fact that the Commission's valuation is confiscatory and is based upon the Commission's wholly undependable guess as to what may happen in the future. (See Opinion of Judge PHILLIPS, Rec., pp. 254; 260.)

The third and last safeguard—the right of veto in one-third of any class to which a Plan is submitted—is now under assault by Reconstruction Finance Corporation and the Group of Insurance Companies and Institutional Investors who are absorbing forfeited equities of junior creditors and stockholders to a point that threatens to become a widespread national scandal.* They say that no group of junior creditors may reject a Plan where the class is

* Reference is here made to Report of the Judiciary Committee of the House of Representatives, 78 Cong. 2d Session, Rep. No. 1615, Railroad Reorganizations under Section 77 of the Bankruptcy Act, Cong. Rec. June 27, 1945, Vol. 91, page 6915.

given the *residuum* of value remaining after senior creditors appear to have been made whole. They say:

> "It has been urged by dissenters, and was urged here by City Bank, that the 'not reasonably justified' phrase contemplates some more favorable provision than the basic canon of 'fair and equitable'. This would frustrate the purpose of the Act, for no Plan could lawfully award any class more than what is fair and equitable; yet each class could veto it unless it did."

That is to say, the right of veto means nothing.

This we categorically deny.

First of all it runs afoul of the rule that effect and meaning must be given to every clause of a statute. The finding of "fair and equitable" indispensable in *every* case would annul the right of veto in *any* case.

This was not the scheme of Section 77.

It must be remembered that Section 77 was designed as a new alternative to the equity procedure of foreclosure and sale. No Plan was to be consummated under this new procedure unless acceptable to two-thirds of each creditor class. The requisite percentage of any class might reject for any fair reason. They might properly reject because dissatisfied with the Commission's valuation, preferring to take their chances of securing a better result through foreclosure and sale. They might properly object because dissatisfied with the kind of capitalization prescribed by the Interstate Commerce Commission. They might properly object because the Plan brings in new properties which they think may prove burdensome.

Or, as is a vital factor in the instant case, they may object because, among other cogent reasons, the Plan reflects a stale record that is obsolete as the result of changed economic conditions and they think there should be a revised Plan on a record that is new and up to date.

If one or more of these reasons of which those mentioned are illustrative are of sufficient merit to impress one-third of a creditor class such class may reject the Plan.

The only qualification of this right is that they may not act capriciously or with an extortionate or improper objective. That is not this case.

As directed by the Circuit Court of Appeals this proceeding goes back to the Interstate Commerce Commission to proceed anew under subsection (d). This means that within six months the Debtor or any group of creditors must file a new Plan which unless *prima facie* impracticable must be set down for a hearing which the Interstate Commerce Commission may deplore but which Congress has ordained and *due process* requires.

The Petition for *certiorari* in Nos. 278-282 does not state a case within Rule 38 and should be denied.

September 5, 1945.

Respectfully submitted,

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